

FROM THE DIRECTOR

• 2006 •

The Montana Lottery is an important part of the financial structure of Montana State Government. In nineteen years of operation, the Montana Lottery has generated more than \$130 million to help fund important programs such as public education, health, safety and other critical government services.

The Lottery's profits are designated by Legislative action. They first went to the Teachers' Retirement system to hold the line on property taxes, then to the School Equalization Aid Account, which supported elementary and secondary schools. Smaller portions were transferred to the Board of Crime Control to help with administrative expenses associated with juvenile detention centers in the State; and a portion helped fund a study on problem gambling.

Since 1995, all proceeds have gone to the General Fund, which acts as the State's checking account. Public education, health and safety programs are important services Montanans expect government to provide. The Montana Lottery is proud of its 19-year history of helping Montanans, while providing fun and profitable Lottery products.

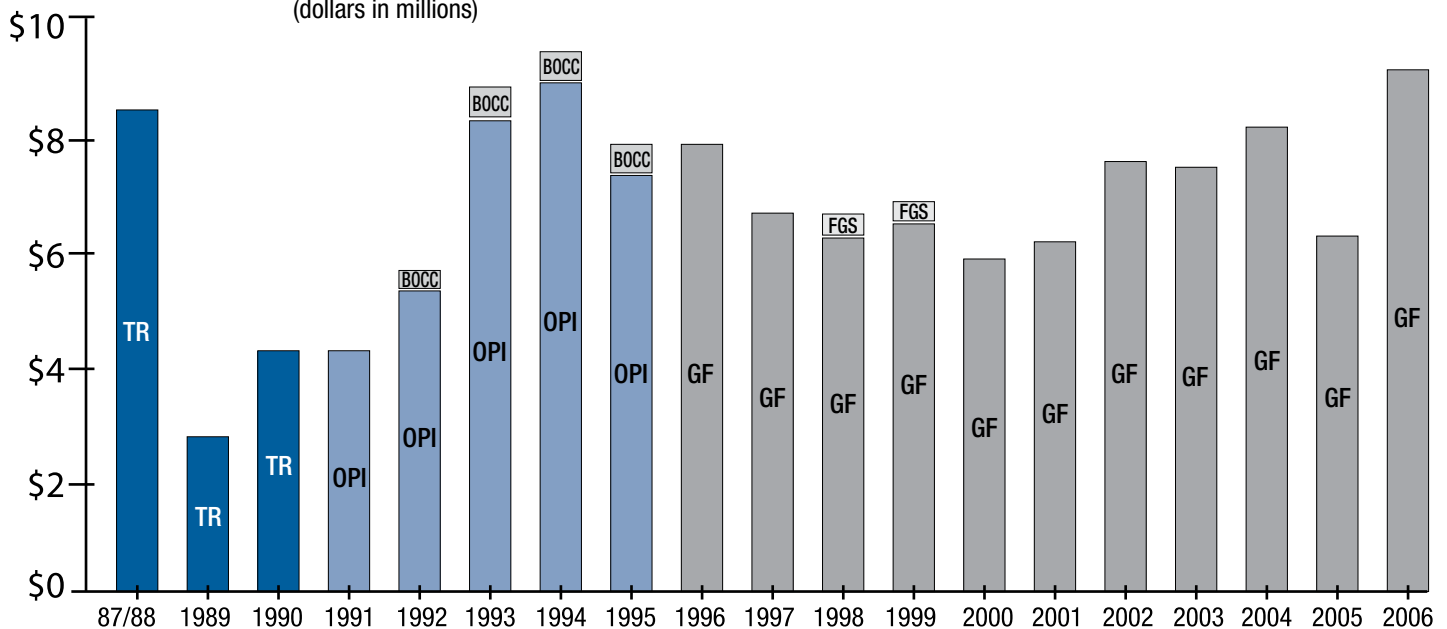


Sincerely,

George E. Parisot

George Parisot
Director

1987 through 2007 Fiscal Year Transfers in dollars and by accounts
(dollars in millions)



- \$15.3 million.....Teachers' Retirement (TR)
- \$34 million.....Office Of Public Instruction (OPI)
- \$2.5 million.....Board Of Crime Control (BOCC)
- \$100 thousand.....Fund Gambling Study (FGS)
- \$78.1 million.....General Fund (GF)

FROM THE COMMISSION

• 2006 •

In Fiscal Year 2006, our Lottery achieved the highest sales and total revenues in its nineteen years of operation. This is a significant accomplishment. In the meantime, expenses for operating the Lottery remained at around \$3 million, in spite of an ever-expanding selection of game offerings.

Of particular note this year were the efforts of the Lottery's Request for Proposal team, which developed and issued an RFP for online services. The resultant contract will save approximately \$13.9 million over the seven-year initial term. The team's achievement was recognized by Governor Schweitzer with his Governor's Award for Excellence. The Commission is proud of

this recognition—and of all the accomplishments of Montana Lottery staff for the past nineteen years.

Finally, we salute the contribution of the Lottery's retailer network. From small-town grocery stores to convenience store chain accounts, these people serve as the front line for players. Our knowledgeable retailer network helps players with questions and graciously provides customer service. The Lottery staff pledges to work effectively with the retailers.

The Lottery commission looks forward to many years of association with the Montana Lottery.



Back row, Wilbur Rehmann, Helena; Craig Anderson, Sheriff, Glendive
Front Row, Beth O'Halloran, Missoula; Robert Crippen, CPA, Chair, Butte;
Thomas M. Keegan, Attorney at Law, Helena

Significant Achievements

- Ticket Sales of \$39.9 Million. This surpassed any year in the Lottery's 19-year history, and was 46 percent over Fiscal Year 2005, and 14 percent over projections.



- Game change to Powerball in August 2005 was instrumental in driving Lottery sales to the highest level in history.



- Successful negotiation of a new contract with Intralot, USA, for operation of the Lottery terminals and related hardware and software. This contract is estimated to save the state \$13.9 million over the seven-year contract term.



Implementation on March 31, 2006, of the new Lottery operating system, including nearly 600 Lottery terminals, the satellite communication system, and the back office system for providing accounting and sales of Lottery products. The system was scheduled to go live at 6 am on Friday, March 31. By 7:30 am, the first ticket, a Powerball ticket, was sold at Ranch Hand in Eureka.

Special Award

The Montana Lottery RFP Team was one of the recipients of the Governor's Award for Excellence in Performance.

The Lottery Team researched, prepared, issued and evaluated an extensive Request for Proposal (RFP) for the new online gaming system. The result of the RFP Process was the installation of a new system at approximately 600 retailers across the state. The team's hard work resulted in an agreement that will save the State of Montana \$13.9 million over the seven-year term of the contract.



Top row-left to right; Terry Street, Warehouse Manager, Jo Berg, Public Relations Manager, Jeri Duran, Sales and Marketing Director, bottom row-left to right; Governor Brian Schweitzer and his dog Jag, Marlene Teel, Sales Manager, Laurie Felch, Products and Creative Manager, Paul Gilbert, Information Services Director and Carol Swick, Finance Director

LOTTERY PRODUCTS

• 2006 •



- First game offered in Montana, in June 1987. In fiscal year 2006, sales of Scratch tickets totaled \$11,239,757.
- The Montana Lottery introduced 33 different Scratch games in fiscal year 2006.
- Games sell for \$1, \$2, \$3, and \$5, and each game features unique play styles, graphics, and prize levels. Prizes paid in fiscal year 2006 totaled nearly \$6.7 million.
- By law, at least 45 percent of all sales are returned to players as prizes. In fiscal year 2006, the overall percentage was 59.2%.
- Overall odds of winning a prize on Scratch tickets are approximately 1 in 4.
- Total number of winners in fiscal year 2006 was approximately 1.5 million.
- Each Lottery retailer receives a 5% commission on gross sales, with the potential for earning additional commissions on sales over base. Retailer commissions in fiscal year 2006 totaled over \$893,000, or almost 8%.



- Montana's own game. The game features frequent jackpot winners—21 Jackpot winners in fiscal year 2006.
- The highest jackpot won in Montana in fiscal year 2006 was \$160,000, sold in Bozeman for the December 28, 2005 drawing.
- In fiscal year 2006, Montana Cash sales totaled \$4,183,258.
- Montana Cash prizes paid in fiscal year 2006 totaled \$2.1 million.
- In fiscal year 2005, overall prize percentage for Montana Cash was approximately 50.9%.
- Total number of winners in fiscal year 2006 was approximately 93,000.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in fiscal year 2006 totaled over \$209,000.



- Played in Montana, Idaho, North Dakota and South Dakota.
- One Montana Jackpot winner in fiscal year 2006, worth \$266,000, and was sold in Great Falls for the September 3, 2005 drawing.
- In fiscal year 2006, Wild Card sales totaled \$2,416,577.
- Wild Card prizes paid in fiscal year 2006 totaled approximately \$1.3 million.
- In fiscal year 2006, overall prize percentage for Wild Card was 52.8%.
- Total number of winners in fiscal year 2006 was approximately 392,000.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in fiscal year 2006 totaled nearly \$121,000.

LOTTERY PRODUCTS

• 2006 •



- Played in 31 Lottery jurisdictions including Montana.
- In fiscal year 2006, Powerball sales totaled \$18,888,081.
- In August, 2005, the Powerball game changed, which resulted in multiple large jackpot runs and resultant increased sales, a 36% increase over the previous fiscal year.
- For an additional \$1 per play, players can choose to add the Power Play option to their ticket, which gives winners a chance to multiply any prize, except the jackpot, up to five times. This feature was supported by an advertising campaign, and a \$1 million winner from Missoula. Power Play sales now total approximately \$1 million per year, and average 15% of total Powerball sales.
- Powerball prizes paid in fiscal year 2006 totaled almost \$9.1 million.
- In fiscal year 2006, overall prize percentage for Powerball was 48%.
- Total number of winners in fiscal year 2006 was approximately 466,000.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in fiscal year 2006 totaled nearly \$945,000.



- Played in ten Lottery jurisdictions including Montana.
- In fiscal year 2006, Montana Hot Lotto sales totaled \$2,774,334.
- Hot Lotto prizes paid in fiscal year 2006 totaled over \$1.3 million.
- In fiscal year 2006, overall prize percentage for Hot Lotto was 48.1%.
- Total number of winners in fiscal year 2006 was approximately 102,000.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in fiscal year 2006 totaled over \$138,000.



- Qwik Tix games are instant win games printed by the Lotto terminal.
- Played only in Montana.
- There are four Qwik Tix — Lucky Numbers, Hot-Tac-Toe, Jacks or Better, and Montana Match.
- In fiscal year 2006, Qwik Tix sales totaled \$416,407.
- Qwik Tix prizes paid in fiscal year 2006 totaled approximately \$250,000.
- In fiscal year 2006, overall prize percentage for Qwik Tix was 60%.
- Total number of winners in fiscal year 2006 was approximately 32,500.
- Each Lottery retailer receives a 5% commission on gross sales. Retailer commissions in fiscal year 2006 totaled almost \$21,000.

PRODUCT HIGHLIGHTS

• 2006 •

Promotions & Events

- Montana Lottery increased visibility around the state by actively seeking opportunities for community involvement by lending support to such entities as Leadership Helena, Montana Shakespeare in the Parks, and local Chambers of Commerce fundraisers.
- Sales and promotions activities at Montana State Fair in Great Falls and Montana Fair in Billings, as well as a number of smaller fairs and community events were fun and exciting for customers and Lottery staff, as we reinvented our Summer Events Program.

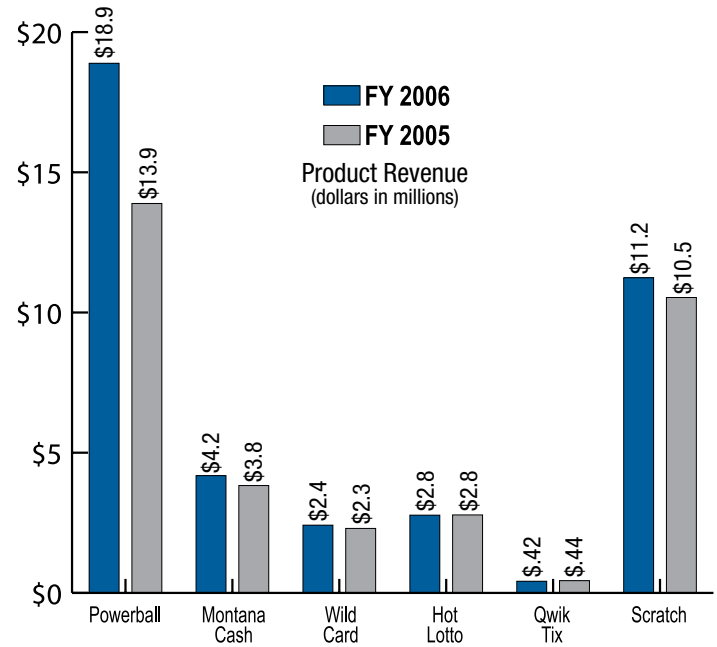


- Winner events were conducted at several Lottery retailers around the State. These events were designed to increase the selling retailer's visibility as a Lottery retailer, and to help communities celebrate a local resident's good fortune.

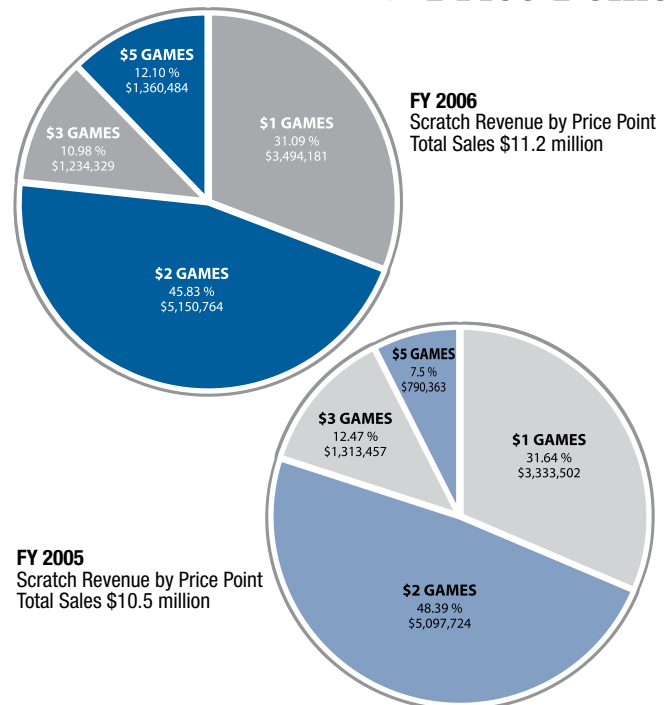


Of particular note was an event in Missoula, in October 2005, celebrating Montana's top prizewinner of Fiscal Year 2006. Brittne Burke Keilman won \$1 million playing Powerball. Brittany chose to add the Power Play option to her ticket, and when she matched five numbers for the second tier prize of \$200,000, the Power Play option multiplied her prize by five, resulting in a \$1 million prize!

Revenue by Product



Scratch Revenue by Price Point



INDEPENDENT AUDITORS' REPORT

• 2006 •

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the accompanying financial statements of the Montana State Lottery (the Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 2006 and 2005. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

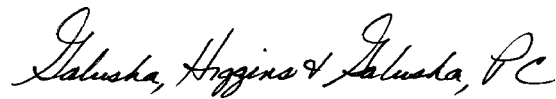
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery, an enterprise fund of the State of Montana, as of June 30, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 8, 2006 on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 8 through 10 are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants and Advisors

Helena, Montana
September 8, 2006

MANAGEMENT'S DISCUSSION & ANALYSIS

• 2006 •

The following *Management Discussion and Analysis* of the Montana State Lottery's (Lottery) activities and financial performance provides the reader with an introduction to and overview of the financial statements for the fiscal years ended June 30, 2006 and 2005. We encourage readers to consider this information in conjunction with the financial statements, which directly follow.

FY 2006 Highlights

During the past year, the Lottery completed a major conversion to a new gaming system operator. Intralot, USA came on line March 31, 2006 as scheduled. This company provides the equipment and communications system that tracks and controls all aspects of the Lottery's sales, ticket validations, and winner payments, including the terminals located at our retailer locations. The Lottery was successful in negotiating this new contract, which required all new equipment, at a substantially reduced cost. The contract provides for payment to Intralot at 5.8% of net sales compared to 8.35% to the previous contractor.

In fiscal 2006, the Lottery's revenues reached a new high of \$39.9 million. This resulted in a transfer to the General Fund of slightly more than \$9.1 million, the largest in the last ten years.

Overview of the Financial Statements

The Lottery is classified as a special-purpose government fund engaged only in business-type activities. Accordingly, the Lottery operates in much the same manner as commercial enterprises using the full accrual method of accounting in accordance with accounting principles generally accepted in the United States of America. The

basic financial statements consist of two components:

Three Fund Financial Statements: a Statement of Net Assets, a Statement of Revenues, Expenses, and Changes in Fund Net Assets, and a Statement of Cash Flows; and Notes to the Financial Statements.

The *Statement of Net Assets* provides information about the nature and amounts included in both short-term and long-term assets and liabilities at the end of the year. Long-term fixed assets are capitalized and depreciated over their useful lives. Because the Lottery is required to transfer all "profits," or the excess of assets over liabilities, to the State's General Fund, its "net assets" will always be zero.

The *Statement of Revenues, Expenses, and Changes in Fund Net Assets* includes all of the current years' revenues and expenses. Revenues are recognized when earned and become measurable, not when they are received. Expenses are recognized when incurred, not when paid. This statement measures the success of the Lottery's operations over the past two years and details the total amount transferred to the General Fund.

The final statement is the *Statement of Cash Flows*. The primary purpose is to provide information about the cash receipts and payments during the reporting period. The statement also reports changes in cash resulting from operations, investing and financial activities, and provides answers to questions such as where cash came from and what cash was used for.

Net Assets

The table below presents a summary of the Lottery's *Statement of Fund Net Assets*.

CONDENSED STATEMENTS OF NET ASSETS AS OF JUNE 30,

	2006	2005	Dollar Change	Percentage Change
Current Assets	\$ 4,724,396	\$ 2,821,842	\$ 1,902,554	67.4%
Capital Assets (Net of Depreciation)	125,608	867,271	(741,663)	-85.5%
Other Assets	1,394,278	1,326,136	68,142	5.1%
Total Assets	\$ 6,244,282	\$ 5,015,249	\$ 1,229,033	24.5%
Current Liabilities	\$ 4,922,739	\$ 3,694,345	\$ 1,228,394	33.3%
Long-Term Liabilities	1,321,543	1,320,904	639	0.0%
Total Liabilities	\$ 6,244,282	\$ 5,015,249	\$ 1,229,033	24.5%
Invested in Capital Assets, Net of Related Debt	\$ 125,608	\$ 867,271	\$ (741,663)	-85.5%
Unrestricted Fund Net Assets	(125,608)	(867,271)	741,663	-85.5%
TOTAL FUND NET ASSETS	\$ 0	\$ 0	\$ 0	0%

MANAGEMENT'S DISCUSSION & ANALYSIS

• 2006 •

The change in Current Assets is due to a \$2 million increase in Cash and Cash Equivalents. Since the Lottery completed payments on its Long Term Debt in late 2004, the Lottery has been able to build our cash position. The \$740 thousand decrease in net Capital Assets is due to depreciation on the previous lottery operating system and amortization of the software associated with that system.

The major change in Current Liabilities is a \$1.2 million increase in the amount due to the General Fund as a result of operations. Total Long-Term Liabilities remained unchanged.

The category, Invested in Capital Assets, Net of Related Debt, consists of capital assets less accumulated

depreciation, amortization and the outstanding balance on the debt related to the purchase of these assets, if any. Since the Lottery is required to transfer the total results of operations to the General Fund, the Net Assets should always be \$ - 0 - and the Unrestricted category is just a balancing figure. This figure can be used to measure asset liquidity and demonstrates where and if the Lottery's funds are obligated.

Operations and Changes in Net Assets

The table below presents a summary of the Lottery's Operations for the last two years.

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS FOR THE YEARS ENDED JUNE 30,

	2006	2005	Dollar Change	Percentage Change
Operating Revenues	\$ 39,928,912	\$ 33,842,650	\$ 6,086,262	18.0%
Ticket Costs	(27,009,013)	(23,358,777)	(3,650,236)	15.6%
Net Operating Revenue	\$ 12,919,899	\$ 10,483,873	\$ 2,436,026	23.2%
Operating Expenses	(4,009,362)	(4,321,626)	312,264	-7.2%
Net Operating Income	\$ 8,910,537	\$ 6,162,247	\$ 2,748,290	44.6%
Non-Operating Income/(Expense)	199,918	60,308	139,610	231.5%
Income before Transfer	\$ 9,110,455	\$ 6,222,555	\$ 2,887,900	46.4%
Transfer to General Fund	\$ 9,110,455	\$ 6,222,555	\$ 2,887,900	46.4%
Changes in Fund Net Assets	\$ 0	\$ 0	\$ 0	0%

Powerball sales were up \$5 million for fiscal year 2006 because of multiple large jackpot runs, the result of a game matrix change completed in August. Montana Cash, Wild Card II and Scratch tickets experienced modest increases in sales, while Hot Lotto and Qwik Tix decreased slightly. Direct Game Costs, which include prizes, operator fees, retailer commissions and scratch ticket printing, are directly related to sales and therefore, also show an increase.

Total Operating Expenses decreased 7.2%. Individual expense categories varied somewhat with both increases and decreases. Specific categories with changes of note were Contracted Services, Personal Services, and Depreciation and Amortization. The Lottery made a one-time payment of \$76 thousand to Batelle in FY 2005 under a contract to evaluate the current operating system preparatory to soliciting bids for a new system. Personal Services increased by \$164 thousand in FY 2006 due to a

Legislative 3.5% increase of all salaries and full employee staffing. Depreciation and Amortization decreased \$279 thousand because the old operating system was retired with the change in contractor. Since it was fully costed out in March, only nine months of depreciation and amortization expense remain in FY 2006.

The income from Non-Operating activities increased from the previous year. This category includes interest received from investments and gains or losses on the sale of non-current assets. Due to the Lottery's improvement in cash position the interest received on investments increased by \$138 thousand; changes due to the sale of non-current assets was negligible.

The increase in sales and slight decrease in operating expenses resulted in the Lottery transferring over \$9.1 million to the General Fund.

MANAGEMENT'S DISCUSSION & ANALYSIS

• 2006 •

Capital Assets and Debt Administration

The Lottery follows the State's policy of capitalizing long-term assets with an historical value of \$5,000 or more. In FY 2005 and the first nine months of Fiscal Year 2006, the Lottery's capital assets were divided into three categories: 1) a fleet of vehicles used by the sales staff, 2) office or computer equipment, and 3) the lottery operating system, which tracked and controlled the sale of all Lottery products, validation of winning tickets, and payments to winners. The operating system consisted of centralized computer equipment and operating software located in Helena and included all of the terminals located at retail locations. With the new operating contract, which began as of March 31, 2006, the Lottery no longer owns the equipment and software; instead, it is provided by Intralot as part of their contract.

Capital assets are depreciated using the straight-line method over the appropriate estimated useful life, ranging from three to seven years.

In Fiscal Year 2006, the Lottery purchased two replacement vehicles for \$42,256 and an office server for \$6,859.

The Lottery currently has no debt-related commitments.

Looking Ahead

The Lottery's goal is to maximize revenue for the State's programs while maintaining the public trust in lottery gaming. This requires offering games that Lottery players want to play, providing convenient locations for the purchase, and controlling operating expenses.

The Lottery begins new scratch games on a regular basis. In fiscal year 2006, 33 games featuring different graphics, play styles, and prizes levels were placed at our retailer sales locations. Approximately the same number of new

games will be presented in fiscal 2007. In August 2006, the Lottery introduced a new concept in scratch tickets called a Family of Games. These are four related games selling for \$1, \$2, \$5 and \$10, all with similar graphics and play styles. The Lottery plans to continue building scratch sales through innovative game themes and product advertising.

The Lottery will continue to look for opportunities to meet the expectations of our players for new and interesting games. We also will continue our efforts to increase the number of retail outlets throughout the state with new terminal placements.

Exceptional increases in lotto revenue are usually the result of higher jackpots; however, such jackpots cannot be predicted nor depended upon to occur at any specific time. Therefore, omitting the possibility of a record jackpot, the Lottery projects that the transfer to the General Fund in Fiscal Year 2007 will be approximately \$9 million.

Contacting the Lottery's Financial Management

This financial report is designed to provide a general overview of the Lottery's finances for all of Montana's citizens, taxpayers, players and creditors, and to report on the Lottery's accountability for its funds. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Montana Lottery, 2525 N. Montana Avenue, Helena, MT 59604.



The Montana Lottery Times • www.montanalottery.com

FINANCIAL STATEMENTS

• 2006 •

STATEMENTS OF FUND NET ASSETS
JUNE 30,

	2006	2005
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 2,365,054	\$ 349,048
Accounts receivable, net of allowance	904,280	1,349,901
Due from primary government	-	9
Due from component units	376	321
Inventory	1,394,354	1,100,853
Collateral securities on loan	33,830	-
Other current assets	26,502	21,710
Total current assets	4,724,396	2,821,842
FURNITURE AND EQUIPMENT		
Furniture and equipment	411,670	5,563,895
Accumulated depreciation	(286,062)	(4,819,838)
Total furniture and equipment	125,608	744,057
INTANGIBLE ASSETS		
Software, net of accumulated amortization	-	123,214
OTHER ASSETS		
MUSL Prize Reserve fund	1,394,278	1,326,136
TOTAL ASSETS	\$ 6,244,282	\$ 5,015,249
LIABILITIES AND FUND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	\$ 298,499	\$ 525,788
Estimated prize liability	1,565,401	1,436,459
Liability for securities on loan	33,830	-
Transfer obligations to general fund	2,709,470	1,526,239
Due to primary government	6,602	7,918
Due to component units	-	5
Deferred revenue	203,786	100,634
Current portion of accrued compensated absences	105,151	97,302
Total current liabilities	4,922,739	3,694,345
LONG-TERM LIABILITIES		
MUSL prize liability	1,241,969	1,257,803
Long-term portion of accrued compensated absences	79,574	63,101
Total long-term liabilities	1,321,543	1,320,904
TOTAL LIABILITIES	6,244,282	5,015,249
COMMITMENTS AND CONTINGENCIES	-	-
FUND NET ASSETS		
Invested in capital assets, net of related debt	125,608	867,271
Unrestricted fund net assets	(125,608)	(867,271)
TOTAL FUND NET ASSETS	-	-
TOTAL LIABILITIES AND FUND NET ASSETS	\$ 6,244,282	\$ 5,015,249

The accompanying notes are an integral part of these financial statements.

FINANCIAL STATEMENTS

• 2006 •

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS FOR THE YEARS ENDED JUNE 30,

	2006	2005
OPERATING REVENUES		
Scratch ticket games	\$ 11,239,757	\$ 10,535,046
Terminal ticket games	28,678,657	23,276,199
Miscellaneous	10,498	31,405
Total operating revenues	39,928,912	33,842,650
DIRECT GAME COSTS		
Scratch ticket prize expense	6,656,048	6,275,935
Terminal ticket prize expense	14,071,484	11,527,966
Retailer commission	2,328,531	1,965,321
Gaming vendor fees	3,083,535	2,822,415
Cost of tickets sold	869,415	767,140
Total direct game costs	27,009,013	23,358,777
Income before operating expenses	12,919,899	10,483,873
OPERATING EXPENSES		
Advertising	493,318	606,394
Advertising production	229,616	145,435
Communications	87,879	91,550
Audit fees	71,483	22,333
Contractual services	112,391	266,639
Depreciation and amortization	790,777	1,069,530
Management fees	53,942	54,318
MUSL operating fees	72,333	88,856
Other	38,262	52,271
Public relations	37,110	27,318
Personal services	1,619,432	1,455,722
Repairs and maintenance	11,101	24,822
Supplies and materials	240,410	273,593
Utilities and rent	113,336	111,067
Travel	37,972	31,778
Total operating expenses	4,009,362	4,321,626
OPERATING NET INCOME	\$ 8,910,537	\$ 6,162,247
NON-OPERATING REVENUES (EXPENSES)		
Interest income	\$ 199,910	\$ 62,033
Securities on loan income	1,985	-
Securities on loan expense	(1,977)	-
Loss on disposal of furniture and equipment	-	(1,725)
Total non-operating net income	199,918	60,308
INCOME BEFORE TRANSFERS	9,110,455	6,222,555
TRANSFERS OUT		
General fund	9,110,455	6,222,555
Total transfers out	9,110,455	6,222,555
Fund net assets, beginning of year	-	-
Fund net assets, end of year	\$ -	\$ -

The accompanying notes are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

• 2006 •



STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30,

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from sales	\$ 40,469,526	\$ 33,671,604
Cash paid to suppliers for goods and services	(8,360,589)	(7,301,718)
Cash paid to employees	(1,598,501)	(1,464,055)
Cash paid for prizes	(20,631,970)	(17,974,108)
Net cash provided by operating activities	9,878,466	6,931,723
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest and dividend income	113,879	19,552
Net cash provided by investing activities	113,879	19,552
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Transfers out:		
General fund	(7,927,224)	(6,885,178)
Net cash used by non-capital financing activities	(7,927,224)	(6,885,178)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of fixed assets	(49,115)	(17,994)
Proceeds from sale of fixed assets	-	3,386
Net cash used by capital and related financing activities	(49,115)	(14,608)
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,016,006	51,489
Cash and cash equivalents, beginning of year	349,048	297,559
Cash and cash equivalents, end of year	\$ 2,365,054	\$ 349,048
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	8,910,537	6,162,247
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	790,777	1,069,530
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	445,621	(200,521)
Due from primary government	9	(9)
Due from component units	(55)	386
Inventory	(293,501)	(66,672)
Collateral securities on loan	(33,830)	-
Other current assets	(4,792)	(5,370)
Long-term receivable	(68,142)	(861)
Interest receivable included in long-term receivable	86,040	41,099
Increase (decrease) in:		
Accounts payable	(227,289)	51,462
Lottery prizes payable	113,108	(117,971)
Liability for securities on loan	33,830	-
Deferred revenue	103,152	36,857
Property held in trust	-	(6,000)
Due to primary government	(1,316)	(2,123)
Due to component units	(5)	5
Compensated absences payable	24,322	(30,336)
Net cash provided by operating activities	\$ 9,878,466	\$ 6,931,723

The accompanying notes are an integral part of these financial statements.



NOTES TO THE FINANCIAL STATEMENTS

• 2006 •

Note A – Summary of Significant Accounting Policies

Organization - The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana.

Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the type and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Department of Administration for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The remaining revenue, less expenses, is transferred to the Montana State General Fund.

Reporting Entity - The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting - The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition - Sales of scratch lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of lotto tickets, Powerball, Wild Card, Hot Lotto and Montana Cash, are made through licensed retailers who market the tickets on a commission basis using computerized terminals. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing. Qwik Tix revenue is recognized at the time of the sale by the retailer.

Cash and Cash Equivalents - Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investments pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Allowance for Uncollectible Accounts - The Lottery uses the allowance method to account for uncollectible receivables. The allowance is based on management's estimate of possible bad debts.

Advertising Costs - Advertising costs are expensed as incurred.

Allowance for Returned Tickets - The Lottery's policy is to accept any unplayed scratch ticket from a retailer for credit without regard to when the ticket or pack of tickets was activated. Therefore, an allowance to recognize the possibility of returns is calculated at the end of each fiscal year.

Inventory - Inventory consists of tickets and supplies. Ticket inventory includes scratch lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated. Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

Prizes - Prize expense is recognized based on a predetermined prize structure for each scratch ticket and terminal game. Free tickets, when used as a part of a game's prize structure, are recorded as a reduction in revenue and not as prize expense.

Unclaimed Prizes - Prizes for the lotto games, Powerball, Wild Card, Hot Lotto, and Montana Cash, must be claimed within six months after the appropriate draw date. Prizes for Qwik Tix must be claimed within six months of the sales date. Prizes for scratch games must be claimed within six months of the announced end of each game. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The combined amounts of unclaimed prizes for terminal games were \$614,524 and \$534,630 and for the scratch games were \$343,447 and \$251,551 for the fiscal years ended June 30, 2006 and 2005, respectively.

NOTES TO THE FINANCIAL STATEMENTS

• 2006 •



Note A – Summary of Significant Accounting Policies (cont.)

Intangible Assets - Intangible assets consisted of software for the old gaming system. This software was purchased in 1999 and had an original cost of \$1,150,000 and was being amortized over seven years. Amortization was complete as of March 2006.

Furniture and Equipment - Furniture and equipment are recorded at cost. Donated furniture and equipment are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of furniture and equipment, the cost and related accumulated depreciation or amortization are removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of three to seven years. The Lottery conforms to the State of Montana capitalization threshold for recording furniture and equipment. This threshold is \$5,000.

Compensated Absences - State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Use of Estimates - The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note B – Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	June 30,	
	2006	2005
Short-term investment pool	\$2,062,806	\$186,928
Cash on deposit with State Treasurer	292,098	151,970
Cash in revolving deposit account	10,000	10,000
Petty cash	150	150
	<u>\$2,365,054</u>	<u>\$349,048</u>

Note B – Cash and Cash Equivalents (cont.)

The Lottery participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less. The bank balance of the revolving deposit account was \$19,221 and \$54,676 at June 30, 2006 and 2005, respectively, and was covered by federal depository insurance up to \$100,000. The carrying amounts reported in the Statements of Fund Net Assets for cash and cash equivalents approximate the fair market value.

Note C – Investment Risk Disclosures

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Account Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). There are four types of risk that must be disclosed. These risks are defined below followed by their applicability to each of the investment pools.

Credit risk is defined as the risk that an issuer to an investment will not fulfill its obligation, i.e., not make timely principal and interest payments.

Custodial credit risk is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party.

Concentration of credit is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States government, and mutual funds of approved investments." Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk nor concentration of credit risk per GASB Statement No. 40.

NOTES TO THE FINANCIAL STATEMENTS

• 2006 •

Note C – Investment Risk Disclosures (cont.)

Multi-State Lottery Association

The securities are held in trust for MUSL by Mellon Trust. This large diversified institution has several national offices, with the Everett, Massachusetts office handling the MUSL account. Interest rate risk is minimized by requiring that the average portfolio maturity be no more than 1.33 years and that the maximum maturity for any one security cannot exceed 5 years.

Short-term Investment Pool

All short-term funds are held in the State's Short Term Investment Pool (STIP) administered by the Board of Investments (BOI). A summarized description of their disclosure follows and full details may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, P.O. Box 200126, Helena, MT 59620-0126.

For STIP securities, BOI's policy to manage credit risk requires securities have the highest investment grade rating in the short-term category by at least one Nationally Recognized Statistical Rating Organization (NRSRO). The six NRSROs include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Per the BOI, all STIP securities are registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank. The STIP investment policy does not specifically address concentration of credit risk. As of June 30, 2006, there were no single issuer investments that exceeded 5% of the STIP portfolio. Per GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a-7-like pool.

Under the provisions of state statutes, the BOI has, by a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank, to lend BOI's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, BOI receives a fee and the bank must initially receive collateral equal to 102% of the market value of the securities on loan and must maintain collateral equal to not less than 100% of the market value of the loaned security. BOI retains all rights of ownership during the loan period. At year-end, the BOI had no credit risk exposure.

Note D – Accounts Receivable

Accounts receivable consists of the following:

	June 30,	
	2006	2005
Accounts receivable	\$1,032,683	\$1,442,990
Allowance for returned tickets	(128,403)	(93,089)
	<u>\$ 904,280</u>	<u>\$1,349,901</u>

Note E – Inventory

Inventory consists of the following:

	June 30,	
	2006	2005
Scratch tickets	\$1,295,163	\$969,756
Supplies	99,191	131,097
	<u>\$1,394,354</u>	<u>\$1,100,853</u>

Note F – Other Current Assets

Other current assets consist of the following:

	June 30,	
	2006	2005
Prepaid Expenses	\$25,034	\$19,960
Employee Travel Advances	1,468	1,750
	<u>\$26,502</u>	<u>\$21,710</u>

Note G – Furniture and Equipment

A summary of furniture and equipment for the Lottery is as follows:

	June 30, 2005	Additions	Deletions	June 30, 2006
Furniture and equipment	\$5,563,895	\$ 49,106	\$(5,201,331)	\$ 411,670
Accumulated depreciation	(4,819,838)	(667,555)	5,201,331	(286,062)
	<u>\$ 744,057</u>	<u>\$(618,449)</u>	<u>\$ -</u>	<u>\$ 125,608</u>



NOTES TO THE FINANCIAL STATEMENTS

• 2006 •



Note H – Multi-State Lottery Association (MUSL)

Joint Venture Association - In November 1989, the Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Powerball game, Wild Card game and Hot Lotto game are presently the only games operated jointly by the members in which the Lottery participates. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Payable - As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which was paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with each game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of \$1,394,278 and \$1,326,136 at June 30, 2006 and 2005, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of \$119,976,521 and \$112,466,060 for 2006 and 2005, respectively. The long-term liability balance of \$1,241,969 and \$1,257,803 at June 30, 2006 and 2005, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto*America Prizes and Investments - Prizes awarded to Lotto*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Lottery and distributed to the grand prize winners on the anniversary date of each win.

At June 30, 2006 and 2005, MUSL held United States Government zero coupon bonds in trust for the Lottery winners with respective par values of \$34,333,949 and

\$39,541,949 and respective market values of \$28,920,120 and \$34,059,006.

The Lottery has eight Lotto*America/Powerball/Tri-West winners. The combined total future prize payments owed is \$34,468,000 and \$39,676,000, at June 30, 2006 and 2005, respectively. The present value of future prize payments approximates the current market value of the bonds held in trust for the Lottery winners.

Total annual payments due as of June 30, 2006 are:

2007	\$ 5,208,000
2008	5,208,000
2009	5,208,000
2010	5,106,000
2011	4,603,000
Thereafter	9,135,000
	<u>\$ 34,468,000</u>

Multi-State Lottery Association Financial Position - Information related to the Multi-State Lottery Association's audited financial statements is as follows:

	June 30,	
	2006	2005
Total assets	<u>\$1,054,179,556</u>	<u>\$1,138,781,518</u>
Total liabilities	1,053,967,990	1,138,555,856
Total net assets	<u>211,566</u>	<u>225,662</u>
Total liabilities and assets, unrestricted	<u>\$1,054,179,556</u>	<u>\$1,138,781,518</u>
Total revenues	\$ 2,694,119	\$ 3,520,580
Total expenses	2,708,215	3,517,918
Increase (decrease) in unrestricted net assets	<u>\$ (14,096)</u>	<u>\$ 2,662</u>

Note I – Estimated Prize Liability

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

Note J – Obligation to Transfer Funds

The Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 2006 and 2005 were \$2,709,470 and \$1,526,239, respectively.

NOTES TO THE FINANCIAL STATEMENTS

• 2006 •

Note K – Long-Term Liabilities

Long-term liabilities consist of the following:

		June 30,		
	Current	Long-Term	2006 Total	2005 Total
Prize liability MUSL	\$ -	\$1,241,969	\$1,241,969	\$1,257,803
Accrued compensated absences	105,151	79,574	184,725	160,403
	<u>\$ 105,151</u>	<u>\$1,321,543</u>	<u>\$1,426,694</u>	<u>\$1,418,206</u>

Note L – Leases

The Lottery leases its office, administrative and warehouse facilities under a non-cancelable lease agreement that is effective March 2002 through February 2007. Rent expense under operating leases charged to operations was \$90,160 and \$88,832 for the years ended June 30, 2006 and 2005, respectively.

Future minimum lease payments under operating leases that have remaining terms in excess of one year as of June 30, 2006 are \$60,704 for the year ending June 30, 2007.

Note M – Employee Benefit Plans

Pension Plan - The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides disability and death benefits to plan members and beneficiaries as well as a choice of a defined benefit or a defined contribution retirement plan.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Montana Public Employees Retirement Administration, P.O. Box 200131, 100 N. Park, Suite 220, Helena, MT 59620-0131, (406) 444-3154.

The contribution rate for the plan is required and determined by State law. The contribution rate for fiscal years 2006 and 2005, expressed as a percentage of covered payroll, was 6.9% for both years, for both the employer and the employees.

The amounts contributed to the plan during the years ended June 30, 2006 and 2005, were \$165,494 and \$155,684, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan - The Lottery's full-time regular employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts are deferred under the plan created under Internal Revenue Code Section 457 and Title 19, chapter 50, Montana Code Annotated (MCA). Assets of the deferred compensation plan are required to be held in trusts, custodial accounts or insurance company contracts for the exclusive benefit of participants and their beneficiaries.

Note N – Related Party Transactions

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 2006 and 2005, total payments to other State agencies were approximately \$211,589 and \$168,783, respectively.

Note O – Commitments, Contingencies and Subsequent Event

Scratch Tickets - The Lottery has an agreement with Oberthur Gaming Technologies Corp. to print scratch game tickets. The contract expires August 8, 2008. The Lottery incurs approximately \$780,000 per year under this contract.

Terminal Vendor - The Lottery is contracted with Intralot, Inc. to provide for the operation of the gaming system through March 30, 2013. The contract provides for three one-year extensions, if agreeable by both parties. The contract price is 5.8% of each \$1 ticket sold, which is an estimated total contract price of approximately \$17 million over the seven-year contract. The new contract price includes the cost of equipment.

Advertising - The Lottery signed a contract with Banik & Associates to provide advertising services for \$5,500 per month through December 2006.



NOTES TO THE FINANCIAL STATEMENTS

• 2006 •

Note O – Commitments, Contingencies and Subsequent Event (cont.)

Independent Observation of Drawings - The Lottery is committed to Galusha, Higgins and Galusha, PC, to observe Montana Cash and other special drawings. The original term of the contract was for three years ending June 30, 2005. Compensation did not exceed \$25,000 for the three year period. The contract was renewed for a three-year period ending June 30, 2008. Compensation under the new agreement will not exceed \$30,000.

Audit of Financial Statements - The Lottery is party to a contract with Galusha, Higgins and Galusha, PC, an independent accounting firm, to audit the Lottery's annual financial statements. The yearly contract was finalized on June 20, 2006, and is renewable for one additional year with the consent of all parties. Compensation for the years ended June 30, 2006 and 2005 will not exceed \$12,000.

Prize Contingencies - Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of \$232,500 and \$465,000 at June 30, 2006 and 2005, respectively, if the insurance carrier defaulted on their payments.

Note P – Risk Management/Public Entity Risk Pool

The Lottery contributes to the Group Employee Comprehensive Medical and Dental Plan and the Property and Casualty Insurance plans of the State of Montana. Details of these plans can be found in the State of Montana Comprehensive Annual Financial Report available through the Department of Administration's website at www.mt.gov/doa/afsd/cafr/cafr.asp.



INDEPENDENT AUDITORS' REPORT

• 2006 •

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS*

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 2006, and have issued our report thereon dated September 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. However, we noted certain immaterial instances of noncompliance that we have reported to management of the Lottery in a separate letter dated September 8, 2006.

This report is intended for the information of the Lottery's Commissioners, management and the Legislative Audit Committee and is not intended to be and should not be used by anyone other than those specified parties.

GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants and Advisors

Helena, Montana
September 8, 2006